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IN THE

Supreme Court of the United States

OCTOBER TERM, 1970

No. [redacted]

M.F.A. CENTRAL COOPERATIVE, *Petitioner*

v.

EDWIN O. ~~BOOKWALTER~~, District Director of Internal Revenue

M.F.A. OIL COMPANY, *Petitioner*

v.

UNITED STATES OF AMERICA

MISSOURI FARMERS ASSOCIATION, INC., *Petitioner*

v.

UNITED STATES OF AMERICA

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

M.F.A. Central Cooperative, M.F.A. Oil Company, and Missouri Farmers Association, Inc. petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Eighth Circuit in the above-entitled cases.[1]

[1] The Eighth Circuit rendered one opinion in five consolidated cases (Nos. 19,527-19,531) brought by these three petitioners pursuant to a stipulation of the parties that the resolution of *M.F.A. Central Cooperative* v. *Bookwalter* (No. 19,527) would control the outcome of the other four cases. Although this petition covers all five cases, we shall, for purposes of convenience, refer herein only to M.F.A. Central Cooperative.

OPINIONS BELOW

The memorandum opinion of the United States District Court for the Eastern District of Missouri (Appendix C, *infra*, pp. 9a-20a) is reported at 286 F. Supp. 956. The opinion of the United States Court of Appeals for the Eighth Circuit (Appendix A, *infra*, pp. 1a-6a) is not yet officially reported.

JURISDICTION

The Judgment of the Court of Appeals (Appendix B, *infra*, pp. 7a-8a) was entered on June 8, 1970. A timely petition for rehearing was denied on July 23, 1970. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

QUESTION PRESENTED

Pursuant to 12 U.S.C. § 1134d(a)(3), and the terms of its loan agreement with the St. Louis Bank for Cooperatives, M.F.A. Central Cooperative, in order to obtain loans from that Bank, was required to agree to purchase, during each year in which such loans were outstanding, Class "C" stock of the Bank, at its par value of $100 per share, in an amount equal to 15% of petitioner's quarterly interest payments to the Bank during such year.

The question presented is whether petitioner is entitled to deduct, as an ordinary and necessary business expense or as interest, the amounts by which such required payments exceeded the fair market value of Class "C" stock so acquired.

STATUTES INVOLVED

Internal Revenue Code of 1954, section 162(a):

> "*In General.*—There shall be allowed as a deduction all the ordinary and necessary expenses

paid during the taxable year in carrying on any trade or business. . . ."

Internal Revenue Code of 1954, section 163(a):

"*General Rule.*—There shall be allowed as a deduction all interest paid or accrued within the taxable year on indebtedness."

STATEMENT OF THE CASE

Prior to and during its fiscal years ending August 31, 1958 and August 31, 1959, petitioner, a farmers' cooperative, borrowed substantial sums from the St. Louis Bank for Cooperatives.

Pursuant to 12 U.S.C. § 1134d(a)(3), and the terms of its loan agreements with the St. Louis Bank, petitioner, in order to obtain such loans, was required to agree to purchase during each year in which loans were outstanding Class "C" stock of that Bank, at its par value of $100 per share, in an amount equal to 15% of petitioner's quarterly interest payments to the Bank during such year. During its 1958 and 1959 fiscal years, petitioner, in compliance with these requirements, made the requisite quarterly purchases of Class "C" stock in the aggregate amount of $20,154.32 in 1958 and $27,966.97 in 1959.

The Class "C" stock could pay no dividends. It was redeemable at par in the discretion of the Board of Directors of the Bank, but only after all "senior stock" (Class "A" stock which could be held only by the government, and Class "B" stock which could be held by anyone) and all previously issued Class "C" stock had been retired or called for retirement. The Class "C" stock here involved entitled petitioner to

no voting rights, no right to share in the profits of the Bank, and no other benefits of any kind.[2]

Petitioner brought this suit for a refund of federal income tax, taking the position that amounts expended in 1958 and 1959, purportedly for the Class "C" stock, were in reality, to the extent they exceeded the fair market value of such stock, payments for the use of money, deductible either as interest under Section 163 of the Internal Revenue Code or as ordinary and necessary business expenses under Section 162 of the Internal Revenue Code. The District Director of Internal Revenue had denied such deductions.

The District Court, concluding that the Class "C" stock had no fair market value, held that petitioner was entitled to a deduction under Section 162 of the Internal Revenue Code for the full amounts paid by it in 1958 and 1959. The Court of Appeals reversed.

REASONS FOR GRANTING THE WRIT

The decision of the Eighth Circuit in this case is in direct conflict with the decision of the Court of Claims in *Penn Yan Agway Cooperative, Inc.* v. *United States*, 417 F.2d 1372 (decided Nov. 14, 1969), and the decision of the Fifth Circuit in *Mississippi Chemical Corp.* v. *United States*, —— F.2d ——, 1970-2 U.S.T.C. ¶ 9601 (decided Sept. 14, 1970). In the instant case, the District Court held that petitioner was entitled to deduct as a business expense under Section 162(a) of the Internal Revenue Code (but not as interest) the

---

[2] In order to become a borrower from the Bank, petitioner had been required by 12 U.S.C. § 1134d(a)(3) to own a "qualifying share" of Class "C" stock of the Bank. This "qualifying share," the tax treatment of which is not in issue here, entitled petitioner to the single vote granted to each Class "C" stockholder. Petitioner's voting rights were not increased by the acquisition of additional shares.

amounts in excess of the fair market value of the Class "C" stock of the St. Louis Bank for Cooperatives which it was required to pay, ostensibly as the purchase price of such stock, but actually for the right to borrow from that Bank.[3] The Eighth Circuit reversed, holding that amounts paid in excess of the fair market value of Class "C" stock were neither ordinary and necessary business expenses nor interest.

In *Penn Yan Agway Cooperative, Inc.*, and *Mississippi Chemical Corp.*, the Court of Claims and the Fifth Circuit, respectively, held that the taxpayers there involved were entitled to deduct, as interest paid under Section 163(a) of the Internal Revenue Code, the amounts in excess of the fair market value of Class "C" stock of the Springfield, Massachusetts and New Orleans, Louisiana Banks for Cooperatives which they were required to pay for such stock in order to be able to borrow from those Banks.[4]

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[3] Concluding that the Class "C" stock had no fair market value, the District Court thus allowed as deductions the entire amounts so paid by petitioner.

[4] While the Court of Claims found "considerable merit" in the reliance by the District Court in the instant case on a theory of deductible business expense under Section 162(a), nevertheless, the Court found that:

> "The more logical basis for the allowance of the claimed deduction in this case under all of the facts and circumstances is that the purchase price of the Class "C" stock (to the extent that such price exceeded the market value of such stock, as such value is conceded by plaintiff) was interest paid and deductible under § 163 of the Internal Revenue Code of 1954, particularly because the amount of such stock required to be purchased by law and by the loan agreements involved was measured by a percentage of the interest payable on plaintiff's outstanding loan obligations to the bank issuing the stock." 417 F.2d. at 1382.

The Fifth Circuit, in *Mississippi Chemical Corp.*, agreed

Thus, the Eighth Circuit has rendered a decision which conflicts with decisions of the Court of Claims and the Fifth Circuit in a case involving an important question of federal law which has not been, but should be, settled by this Court. The divergent results prevent uniform taxation of the thousands of cooperatives which borrow from Banks for Cooperatives and which are required as a condition of their loans to "purchase" at a price (par value) far in excess of fair market value Class "C" stock of the Banks from which they borrow. In these circumstances, review by this Court is plainly warranted.

CONCLUSION

The petition for certiorari should be granted.

Respectfully submitted,

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October 1970.

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No. 19,527.

M. F. A. CENTRAL COOPERATIVE, *Appellee*,

v.

EDWIN O. BOOKWALTER, District Director, etc., *Appellant*.

No. 19,528.

M. F. A. OIL COMPANY, *Appellee*,

v.

UNITED STATES OF AMERICA, *Appellant*.

No. 19,529.

MISSOURI FARMERS ASSOCIATION, INC., *Appellee*,

v.

UNITED STATES OF AMERICA, *Appellant*.

No. 19,530.

M. F. A. OIL COMPANY, *Appellee*,

v.

UNITED STATES OF AMERICA, *Appellant*.

No. 19,531.

MISSOURI FARMERS ASSOCIATION, INC., *Appellee*,

v.

UNITED STATES OF AMERICA, *Appellant*.

Appeals from the United States District Court for the Eastern District of Missouri.

Opinion

Before VAN OOSTERHOUT, *Chief Judge*; BLACKMUN and HEANEY, *Circuit Judges*.

VAN OOSTERHOUT, Chief Judge.

The timely appeals in these consolidated cases are from final judgments of the District Court granting plaintiff taxpayers refunds on income tax payments made for the fiscal years ending in 1958 and 1959. The trial court's jurisdiction and our jurisdiction upon appeal are established.

Case No. 19,527, M.F.A. v. Bookwalter, was tried to the court without a jury. Judgment was entered in favor of the taxpayer. The trial court's opinion, which fairly states the facts, the issues and the basis of the court's decision, is reported at 286 F.Supp. 956.

The taxpayers involved in these appeals are farmers' cooperative associations organized under the laws of Missouri. The St. Louis Bank for Cooperatives, hereinafter called the Bank, is one of twelve regional banks for cooperatives. The central bank for cooperatives and the regional banks were organized for the purpose of extending credit exclusively to farmers' marketing, purchasing and service corporations. 12 U.S.C.A. § 1134 et seq. See Legislative history, Farm Credit Act of 1955, U. S. Code Administrative News 1955, Vol. 2, pp. 2947-51. Each regional bank pursuant to federal statute issued three classes of stock. The stock here involved is Class C stock which is issued only to banks for cooperatives and farmers' cooperative associations. Under § 1134d(a), each farmers' cooperative borrowing from the regional bank is required to invest in Class C stock to the extent of 15% of the interest payable by it to the bank. It is the payment made by taxpayers to the bank pursuant to this provision that is in controversy here.

The Act and its legislative history disclose that the original capital would be contributed by the government in exchange for Class A stock; that Class C stock would ultimately replace the Class A stock and become the capital of the bank and that all the bank stock would ultimately be owned by the farmers' cooperatives. As additional capital in the form of Class C stock flowed in, the oldest Class C

stock would be redeemed at its $100 per share par value on a revolving fund basis.

The banks were a financial success. The cooperatives were able to obtain financing at a favorable interest rate. Some of the Class C shares of stock have been redeemed. While the Class C stock has no established market value, it has a substantial book value and while it is likely not worth its par value at the time it is issued, it certainly has substantial value.

Transfer of Class C stock is severely restricted. The stock pays no dividends. Each shareholder is limited to one vote regardless of the amount of stock owned. The government retains considerable control over the operation of the central bank and the regional banks.

More detailed factual material with respect to the bank for cooperatives may be found in the trial court's opinion and the statutes and legislative history hereinabove referred to.

The parties to all appeals described in the caption have agreed that the resolution of case No. 19,527 will control the outcome of all the consolidated cases.

The issue presented in the appeal in case No. 19,527 is whether the amount paid by taxpayer in the 1958 and 1959 fiscal years for purchase of Class C stock of the St. Louis Bank for Cooperatives as a condition of its right to borrow from the bank is deductible from taxpayer's income either as interest under § 163 I.R.C. 1954 or as a necessary and ordinary business expense under § 162 I.R.C. 1954. The same basic issue is presented in the remaining appeals.[1]

---

[1] The question of whether Class C stock issued the taxpayer as a patronage dividend in the tax years here involved should be reported as taxable income was at issue before the trial court and resolved in favor of the taxpayer. The government in its brief specifically states that it is not appealing upon such issue and hence the issue is not before us.

The trial court rejected taxpayer's contention that the payment made for Class C stock was deductible as interest. We agree with the trial court's determination of the interest issue and affirm upon the interest issue on the basis of the trial court's opinion as reported at pp. 958-60 of 286 F. Supp.[2]

The trial court upheld the taxpayer's contention that payments made for Class C stock were ordinary and necessary business expense deductible from income under § 162. It is quite true that it was necessary for the taxpayer to purchase the Class C stock in order to maintain its eligibility to borrow from the Bank. The Court of Claims in Penn Yan Agway Cooperative, Inc. v. United States, 417 F.2d 1372, discusses quite extensively the statutory background and purpose and considers the deductibility of the required amount paid for Class C stock purchases as a business expense but it does not base its decision on the ground that the stock purchase price is a business expense. At p. 1376, the Court points out the interest advantages in borrowing from the Bank of Cooperatives exceed the 15% required for investment in Class C stock. Under § 1134d(c) the Bank is given a lien upon all Class C stock owned by a borrowing corporation upon loans made to such borrower. Thus the stock a cooperative is required to purchase serves the additional purpose of being collateral for loans made.

The burden is on the taxpayer to establish that the expenses are both necessary and ordinary. Welch v. Helvering, 290 U. S. 111, 115; Greenspon v. Commissioner, 8 Cir., 229 F.2d 947, 954.

In Commissioner v. Tellier, 383 U. S. 687, 689-90, the Court with respect to the word "ordinary" states:

> "The principal function of the term 'ordinary' in § 162 (a) is to clarify the distinction, often difficult,

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[2] In so doing, we have considered the reasoning of Mississippi Chemical Corp. v. United States, 23 AFTR 2d 69-1039 and that of the Court of Claims in Penn Yan Agway Cooperative, Inc. v. United States, 417 F.2d 1372.

between those expenses that are currently deductible and those that are in the nature of capital expenditures, which, if deductible at all, must be amortized over the useful life of the asset. *Welch* v. *Helvering*, supra, at 113-116."

For further discussion of what constitutes an ordinary expense, see Deputy v. du Pont, 308 U. S. 488, 495; Welch v. Helvering, supra; Greenspon v. Commissioner, supra. The taxpayer has not met the burden of establishing that the expenditure here involved is an ordinary expenditure.

Moreover, § 1221 I.R.C. 1954 defines capital asset as follows: "[T]he term 'capital asset' means property held by the taxpayer (whether or not connected with his trade or business), . . ." The Class C stock purchased by the taxpayer fully meets such definition and does not meet any of the exclusions contained in § 1221.

Gain or loss on a capital asset is not recognized until the asset is sold or exchanged. There was no sale or exchange of the Class C stock in the tax years here involved.

Section 165 I.R.C. 1954 includes a share of stock in its definition of a security and provides that if a security becomes worthless it may be treated as a loss from a sale or exchange on the last day of the taxable year. There is no substantial evidence to establish that the stock was worthless at any time. On the contrary, the evidence establishes that Class C stock has a substantial value. The statutes under which the Class C stock was purchased clearly contemplate that the borrowing cooperative acquire stock in the lending bank. The agreement entered into between the bank and the taxpayer, set out at p. 959 of 286 F. Supp., clearly indicates that the taxpayer agreed to invest in capital stock of the bank in accordance with the statutory directive.

In Greenspon v. Commissioner, we stated:

"An allowance for deductions from gross income does not turn on general equitable considerations. Deduc-

> tions depend upon legislative grace and are allowable only to the extent authorized by statute. Deputy v. du Pont, 308 U.S. 488, 493, 60 S. Ct. 363, 84 L.Ed. 416; Interstate Transit Lines v. Commissioner, 319 U.S. 590, 593; 63 S. Ct. 1279, 87 L.Ed. 1607." 229 F.2d 947, 954.

What is said there applies to our situation here.

We hold that the Class C stock which the taxpayer was required to purchase is a capital asset within the meaning of the Internal Revenue Code and that as such, the price paid for the stock cannot be considered an ordinary business expense.

We reverse the judgments appealed from in the five consolidated cases with respect to the determination made by the trial court that the expenditures made for Class C stock constitute necessary and ordinary business expense. We agree with the trial court that the price paid for such stock does not constitute interest.

The cases are remanded to the trial court for further proceedings consistent with the views herein expressed.

APPENDIX B

UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

September Term, 1969

No. 19527

M.F.A. CENTRAL COOPERATIVE, a Missouri Corporation,
Appellee,

v.

EDWIN O. BOOKWALTER, District Director of Internal Revenue at St. Louis, Missouri,
Appellant.

No. 19528

M.F.A. OIL COMPANY, a Missouri Corporation,
Appellee,

v.

UNITED STATES OF AMERICA,
Appellant.

No. 19529

MISSOURI FARMERS ASSOCIATION, INC., a Missouri, Corporation,
Appellee,

v.

UNITED STATES OF AMERICA,
Appellant.

No. 19530

M.F.A. OIL COMPANY, a Missouri Corporation,
Appellee,

v.

UNITED STATES OF AMERICA,
Appellant.

No. 19531

MISSOURI FARMERS ASSOCIATION, INC., a Missouri, Corporation, *Appellee*,

v.

UNITED STATES OF AMERICA, *Appellant*.

Appeals from the United States District Court for the Eastern District of Missouri.

Judgment

These causes (Nos. 66C 424(2), 67C 352(2), 67C 353(2), 67C 354 and 68C 12841) in the District Court) came on to be heard on the joint appendix from the United States District Court for the Eastern District of Missouri and were argued by counsel:

On Consideration Whereof, it is now here ordered and adjudged by this Court that the judgments of the said District Court appealed from in these five consolidated causes with respect to the determination made by the trial court that the expenditures made for Class C stock constitute necessary and ordinary business expense, be, and are hereby, reversed.

And it is further ordered by this Court that these causes be, and they are hereby, remanded to the said District Court for further proceedings consistent with the views expressed in the opinion of this Court filed herein.

June 8, 1970

Costs taxed in favor of the appellants:—

Printing appellants' portion of Appendix	$1,520.65
Printing brief of appellants	247.10
Total costs of appellants for recovery from appellees in U. S. District Court.	$1,767.75

APPENDIX C

M. F.A. Central Cooperative, a Missouri Corporation

v.

Edwin O. Bookwalter, District Director of Internal Revenue at St. Louis, Missouri.

No. 66 C 124(2).

United States District Court
E. D. Missouri.

June 14, 1968.

Harold S. Cook and D. Jeff Lance,
Cook, Murphy, Lance & Mayer,
St. Louis, Mo., for plaintiff.

Veryl L. Riddle, U. S. Atty.;
Jim J. Shoemake, Asst. U.S. Atty., St. Louis, Mo.,
Elliott H. Kajan, Atty., Dept. of Justice, Washington, D.C.,
for defendant.

Memorandum

Meredith, District Judge.

This action was brought by M.F.A. Central Cooperative against Edwin O. Bookwalter, District Director of the Internal Revenue, seeking a refund in federal income taxes paid in prior years. This Court has jurisdiction under 28 U.S.C. 1346(a) (1). The matter was tried to the Court without a jury.

Plaintiff is a farmers' cooperative organized under the laws of Missouri. Its books are kept on a September 1st to August 31st fiscal year basis. In the fiscal years 1958 and 1959, and since that time, the plaintiff borrowed money from the St. Louis Bank for Cooperatives.

The St. Louis Bank for Cooperatives is one of twelve regional banks for cooperatives originally established as part of the New Deal. The banks for cooperatives are organized and governed by the provisions of Subchapter V of Chapter 7, Title 12, U.S.C. The twelve regional banks for cooperatives and the Central Bank for Cooperatives were organized to extend credit to farmers' marketing, purchasing, and service cooperatives. See Legislative History, Farm Credit Act of 1955, U.S. Code & Adm. News 1955, Vol. 2, pp. 2949-51.

A regional bank for cooperatives has three classes of stock:

Class A stock represents capital contribution by the United States; it is non-voting, does not pay dividends, and is to be retired at par according to a method which depends upon the Class C stock purchased and the net profit of the regional bank.

Class B stock may be sold to any person, is non-vofing, but may pay a dividend not to exceed four percent per annum.

Class C stock may be issued only to banks for cooperatives and farmers' cooperative associations. Class C stock may be acquired by a farmers' cooperative in three ways. First, a farmers' cooperative to be eligible to borrow from a bank for cooperatives must purchase one share of Class C stock at its par value of $100. Second, each borrower is required to invest quarterly a specified amount in Class C stock. The amount to be invested each quarter is determined by the board of directors of the regional bank for cooperatives, and is based on a percentage (not less than ten nor more than twenty-five percent) of the interest payable by the individual borrower for that quarter. The third way in which a farmers' cooperative may receive Class C stock is as a result of payment of net profits earned by the regional bank for cooperatives during its fiscal year. These

net profits are paid as patronage refunds in the form of Class C stock in proportion to the amount of interest earned on the loans of each borrower as compared to the total interest earned on the loans to all borrowers during that fiscal year. Class C stock may be issued in fractional shares. No dividends are payable on Class C stock. The holders of Class C stock are entitled to vote, but only on the basis of one vote for each stockholder, regardless of the number of shares held. To be eligible to exercise this right to vote, the farmers' cooperative must have been a borrower from the regional bank for cooperatives within the two years preceding the date of voting. See 12 U.S.C. § 1134d(a) and 12 U.S.C. § 1134*l*.

The controversy in the case presently before the Court is the nature of the payments made by M.F.A. Central Cooperatives to the St. Louis Bank for Cooperatives for Class C stock required to be purchased quarterly as set forth above.

M.F.A. Central Cooperative, at the close of its fiscal year on August 31, 1958, was indebted to the St. Louis Bank for Cooperatives in an amount of approximately $3,300,000. During that fiscal year it paid interest to the St. Louis Bank for Cooperatives, which it deducted as an expense on the federal income tax return filed for the fiscal year. It did not deduct as an expense $20,154.32 paid quarterly during that fiscal year for Class C stock in the St. Louis Bank for Cooperatives. This amount was carried on the books of M.F.A. Central Cooperative in an asset account entitled "Class C Stock, St. Louis Bank for Cooperatives". An amended federal income tax return was filed later and the $20,154.32 was deducted as an expense.

At the end of its fiscal year on August 31, 1959, M.F.A. Central Cooperative was indebted to the St. Louis Bank for Cooperatives in an amount of approximately $3,800,000.

The interest paid on this indebtedness during the fiscal year was deducted on the federal income tax return filed for that period. The total quarterly payments of $27,966.97

for Class C stock in the St. Louis Bank for Cooperatives were also deducted as an expense. The $27,966.97 was reflected on the books of M.F.A. Central by crediting to "Class C Stock, St. Louis Bank for Cooperatives" the sum of $23,211.07 (the fiscal year of M.F.A. Central and the quarterly statement periods of the St. Louis Bank did not coincide, so $4,755.90 was entered in "Accrued Interest" account of the plaintiff).

The District Director of the Internal Revenue denied the deductions attributable to the purchase of Class C Stock and assessed additional tax (including interest) of $751.74 and $6,151.78 for the fiscal years 1958 and 1959, respectively. The assessments were paid, and claims for refund filed and denied. This action was commenced to secure refund of these payments.

The plaintiff contends that to the extent that the payments for Class C stock exceed the fair market value of the stock issued therefor, then such payments are deductible from ordinary income as interest under section 163 of the Internal Revenue Code or as ordinary and necessary business expense under section 162(a) of the Internal Revenue Code. M.F.A. Central states that it is academic under which section the payments fall. The defendant contends that the quarterly payments for Class C stock are capital expenditures and not deductible under either of the above sections. The plaintiff argues that the issue is not whether the expenditures are of a capital nature, but that the issue is the fair market value of the Class C stock. It contends that to the extent of the fair market value of the Class C stock, the expenditure would be of a capital nature, but to the extent that the Class C stock does not have a fair market value, then the payments are deductible. The determination of deductions under the Internal Revenue Code cannot be approached in this manner. Section 63(a) of the Internal Revenue Code provides: "the term 'taxable income' means gross income, minus the deductions allowed by this

chapter, * * *'" Congress thus provides explicitly for the deductions which may be taken by a taxpayer. It is necessary to examine the particular provisions of the Internal Revenue Code to determine whether a given expenditure is deductible.

Whether Deductible as Interest

[1] Interest may be deducted from gross income under section 163(a) of the Internal Revenue Code. This section provides: "[t]here shall be allowed as a deduction all interest paid or accrued within the taxable year on indebtedness." Interest has been defined as that amount which one has contracted to pay for the use of borrowed money. Old Colony Railroad Co. v. Commissioner, 284 U.S. 552, 52 S.Ct. 211, 76 L.Ed. 484 (1932); Deputy v. du Pont, 308 U.S. 488, 60 S.Ct. 363, 84 L.Ed. 416 (1940). A loan agreement, dated July 11, 1958, between the plaintiff and the St. Louis Bank for Cooperatives was introduced into evidence by the plaintiff. It was said to be typical of those used during the relevant period of time. The agreement provided for the payment of interest and the purchase of Class C stock in the following separate paragraphs:

"INTEREST:

Each advance made hereunder shall bear interest at the rate prescribed by the bank in accordance with law, payable quarterly on the last day of March, June, September, and December; provided, however, that if the interest rate charged by the bank on loans similarly classified is changed to a higher or lower rate than the rate effective on the date hereof, the association agrees to pay such higher rate, and the bank agrees to accept such lower rate on the unpaid balance hereunder, from the effective date of such change of interest rate.

"INVESTMENT IN CLASS C STOCK:

Advances hereunder shall be subject in all respects to the provisions of the Farm Credit Act of 1955 and regu-

lations issued pursuant thereto. The association shall invest quarterly in Class C stock of the bank an amount equal to 15% of the amount of interest payable by the association to the bank during the calendar quarter. * * * "

The agreement from which the above paragraphs are extracted was signed by a vice president of the St. Louis Bank for Cooperatives and by a vice president of M.F.A. Central Cooperative. Testimony at the trial stated that a separate note and mortgage were executed.

[2] The provisions of the above agreement seem to indicate that the payments for Class C stock were not considered by the parties to be payments for the use of money. The interest and the payments for Class C stock were set forth in separate paragraphs. If this amount spent on Class C stock is to be considered interest, it would seem that it would be in the nature of a bonus paid for the loan. Several cases have held that a bonus paid to induce a loan was interest within the meaning of the Internal Revenue Code. Wiggin Terminals, Inc., 36 F.2d 893 (1st Cir. 1929) (payment of $50,000 cash bonus); L-R Heat Treating Co., 28 T.C. 894 (1957) ($61,200 withheld from amount paid to borrower, "as premium for making loan"); Court Holding Co., 2 T.C. 531 (1943), rev'd on other grounds, 143 F.2d 823 (5th Cir. 1944), aff'd on other grounds, 324 U.S. 331, 65 S.Ct. 707, 89 L.E. 567 (1945) (payment of $350 cash bonus). These cases are distinguishable from the present matter, because in each of the cited cases the debtor parted with the additional money and received nothing in return other than the use of the lender's money. In the present situation, M.F.A. Central Cooperative parted with the additional money and received stock in the St. Louis Bank, which had a corresponding face value.

The amount of money spent each quarter to purchase the Class C stock is not interest. The plaintiff by this expenditure purchased something other than the use of money.

Whether Deductible as Ordinary and Necessary Business Expenses

Ordinary and necessary business expenses may be deducted from income under section 162(a) of the Internal Revenue Code. This section provides that "[t]here shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred * * * in carrying on any trade or business. * * *". The United States Supreme Court in commenting on this section in Commissioner v. Tellier, 383 U.S. 687, 86 S.Ct. 1118, 16 L.Ed.2d 185 (1966), said:

> "The principal function of the term 'ordinary' in § 162(a) is to clarify the distinction, often difficult, between those expenses that are currently deductible and those that are in the nature of capital expenditures, which, if deductible at all, must be amortized over the useful life of the asset."

Whether or not the expenditures of the taxpayer for the Class C stock in this case are deductible under section 162(a) turns upon whether they are in the nature of a capital expenditure or a day-to-day business expense.

The cases of Ancel Greene & Co., 38 T.C. 125 (1962), and McMillan Mortgage Co., 36 T.C. 924 (1961), are cited by both parties in support of their positions. The taxpayers in these cases purchased stock in the Federal National Mortgage Association. The Federal National Mortgage Association was established by Congress to provide a "secondary market facility for home mortgages." 12 U.S.C. § 1716. The taxpayers in both of these cases were engaged in the business of buying (or developing), servicing, and selling mortgages on residential property. Some of the mortgages which the taxpayers held they sold to the Federal National Mortgage Association. Congress provided in the enacting legislation that a certain percentage of the price which the Federal National Mortgage Association

would pay for a mortgage would be paid in the capital stock of the Association.

The taxpayer in *McMillan Mortgage Co.*, supra, sold mortgages to the Federal National Mortgage Association and received part of the purchase price in the form of capital stock in the Association. It normally sold the stock on the market at a loss. The taxpayer contended that the Federal National Mortgage Association stock which it acquired was not a capital asset under the particular facts of its business, but the expenditure therefor was a deductible business expense under section 162 of the Internal Revenue Code, and that the subsequent disposition of the stock resulted in ordinary gain or loss. The Tax Court agreed. M.F.A. Central Cooperative cites this holding supporting its position in this suit. There is a similarity in that the taxpayer in each situation is required to invest in the capital stock of a corporation created by Congress as a prerequisite to availing itself of the services offered by the corporation. The case does not turn upon the involuntary nature of the purchase, however. In the *McMillan* case the Tax Court specifically found that the stock was not acquired for investment purposes. The court looked to the particular facts of the taxpayer's business:

> "Petitioner's business activity of acquiring and selling FNMA stock was a necessary adjunct to its mortgage business not unlike the situation of a franchise automobile dealer who is in the used car business in acquiring and selling trade-ins. Petitioner acquired and sold the stock as a normal day-to-day business activity of its mortgage business and the stock was not a capital asset in its hands."

There is a more basic distinction between the taxpayers in the *McMillan* and *Ancel Greene* cases and M.F.A. Central Cooperative in this action. This distinction is drawn out by examining the Tax Court's holding in *Ancel Greene &*

Co., supra. In this case the taxpayer did not dispose of the Federal National Mortgage Association stock as it received it, but held it for considerable time. The Tax Court found that the stock was held for investment purposes and was a capital asset when sold by the taxpayer. The Court considered the issue of whether the taxpayer must take the face or par value of the stock into income in the year in which it was acquired or only the fair market value. The Court held that the taxpayer was required to report only the fair market value of the securities received. M.F.A. Central Cooperative points out that this has the same economic effect on taxable income as allowing a deduction for the amount of the purchase price above the fair market value. This is the essence of M.F.A. Central Cooperatives' contention in the present action. It contends that it should be allowed a deduction from income for the difference between the amount expended to purchase the Class C stock and the fair market value of the stock which it receives.

[3] Whether or not an expenditure is deductible as an ordinary and necessary business expense depends upon the nature of the expenditure as compared with the nature of the taxpayer's business. It is normally a question of fact. Justice Cardozo remarked in a case involving the issue of what was an "ordinary" expense:

> "Here, indeed, as so often in other branches of the law, the decisive distinctions are those of degree and not of kind. One struggles in vain for any verbal formula that will supply a ready touchstone. The standard set up by the statute is not a rule of law; it is rather a way of life. Life in all its fullness must supply the answer to the riddle." Welch v. Helvering, 290 U.S. 111, 114-115, 54 S.Ct. 8, 9, 78 L. Ed. 212 (1933).

When we examine the nature of the taxpayer's business and the expenditure for Class C stock, it becomes

apparent that the only reason the stock was purchased was because it was a condition imposed by the bank in making the loan. M.F.A. Central Cooperative would not have purchased the stock otherwise. There was no dividend payable on the stock. Although the stock would be redeemed at par, such redemption was at the option of the bank. The money expended for the stock would be tied up for many years without benefiting the taxpayer in any manner. The Class C stock issued in 1956 was not redeemed until 1967.

This Class C stock could not be disposed of except to another eligible cooperative, and then only with the permission of the bank. In practice the only time a cooperative would acquire Class C stock from another cooperative was as the result of a merger. The rights which a shareholder had as an incident of owning Class C stock did not increase with the purchase of additional shares. The Class C shareholder who owned one share had the same vote as a shareholder who owned one thousand shares. The right to the one vote was an incident of ownership of the first qualifying share purchased.

This Class C stock purchased quarterly was of absolutely no use or benefit to M.F.A. Central Cooperative. It paid no dividend and possessed no rights. The only reason it was purchased was because M.F.A. Central wanted to borrow money from the St. Louis Bank for Cooperatives and the agreement to purchase the Class C stock was imposed as a condition of the loan. It is impossible to separate the loan from the purchase of the stock. One was the motivation for the other.

This situation is similar to the transaction entered into by the taxpayer in Smith & Welton v. United States, 164 F.Supp. 605 (E.D.Va. 1958). The taxpayer in that case was a retail clothing store which had been selling garments manufactured by Handmacher-Vogel, Inc. Handmacher, seeking capital to expand its operations, informed the

taxpayer that the taxpayer would not be allowed to handle its clothing in the future unless five hundred shares of Handmacher stock at $10 per share were purchased. The taxpayer purchased the stock and later sold it at a loss. The Court found that the stock was not held for investment purposes, but was a business expense, and held that the loss was an ordinary loss and not a capital loss. The Court noted that the stock purchase could not be divorced from the circumstances which surround the acquisition.

Other cases of this nature are discussed in 3B Mertens, § 22.16, under the topic of "Tie-In Purchases". The Government cites a case involving a tie-in purchase as authority for its argument that the Class C stock is a capital investment. In Exposition Souvenir Corp. v. Commissioner of Internal Revenue, 163 F.2d 283 (2d Cir. 1947), as condition precedent to obtaining a concession at the New York World's Fair, the taxpayer was required to purchase debentures issued by the Fair. The debentures were later sold at a loss and the taxpayer sought to deduct the loss as an ordinary loss. The Court held, however, that the debentures were capital assets and the loss was not an ordinary and necessary business expense. This holding has been modified by subsequent holdings of the same Circuit. See Commissioner v. Bagley & Sewall Co., 221 F.2d 944 (2d Cir. 1955). Subsequent cases from other circuits and the Tax Court indicate that the view taken by the Second Circuit in Exposition Souvenir Corp. v. Commissioner of Internal Revenue, supra, is not the accepted view at the present. See Booth Newspapers, Inc. v. United States, 303 F.2d 916 (Ct. Claims 1962); Electrical Fittings Corp., 33 T.C. 1026 (1960); Western Wine & Liquor Co., 18 T.C. 1090 (1952), petition for review dismissed 205 F.2d 420 (8th Cir. 1953).

The Government also raises the issue of the treatment of patronage dividends received in the form of Class C stock in the St. Louis Bank for Cooperatives during the

tax years in issue. The taxpayer, M.F.A. Central Cooperative, did not take the par value of the Class C stock received as patronage dividends into income. It entered the entire patronage dividend on its books at the value of $1.00. The Government contends that M.F.A. Central Cooperative should have taken the entire par value of the Class C stock received as patronage dividends into income.

Based upon the nature of the Class C stock as discussed previously, this Court is of the opinion that the Class C stock issued by the St. Louis Bank for Cooperatives did not have a fair market value at the time it was issued, and plaintiff properly did not include it in income.

Accordingly, judgment will be entered for the plaintiff in this case. This memorandum will be adopted in companion cases, Nos. 67 C 253, 67 C 253, and 67 C 254, which involve the same issue, and judgment will be entered for the plaintiffs in those cases.

Plaintiff shall submit judgments to the Court within 10 days after consultation with defendant.

UNITED STATES COURT OF APPEALS

FOR THE EIGHTH CIRCUIT

September Term, 1969

No. 19527. M.F.A. Central Cooperative, etc., Appellee
v. Edwin O. Bookhalter, etc., Appellant.

No. 19528. M.F.A. Oil Company, etc., Appellee,
v. United States of America, Appellant.

No. 19529. Missouri Farmers Association, Inc., etc., Appe
v. United States of America, Appellant.

No. 19530. M.F.A. Oil Company, etc., Appellee,
v. United States of America, Appellant.

No. 19531. Missouri Farmers Association, Inc., etc., Appe
v. United States of America, Appellant.

The Court having considered petition for rehearin
filed in the above cases, and being fully advised in
the premises, it is now here ordered that the petition
for rehearing be, and it is hereby, denied.

July 23, 1970

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Supreme Court, U.S.
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70-22

No. ~~824~~

In the Supreme Court of the United States

OCTOBER TERM, 1970

M.F.A. CENTRAL COOPERATIVE, ET AL., PETITIONERS

v.

EDWIN O. BOOKWALTER, DISTRICT DIRECTOR OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT

ERWIN N. GRISWOLD,
Solicitor General,
Department of Justice,
Washington, D.C. 20530.

In the Supreme Court of the United States

OCTOBER TERM, 1970

No. 824

M.F.A. CENTRAL COOPERATIVE, ET AL., PETITIONERS

v.

EDWIN O. BOOKWALTER, DISTRICT DIRECTOR OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT

Petitioners are cooperative agricultural associations which own shares in the St. Louis Bank for Cooperatives. The St. Louis Bank is one of twelve such regional banks, each located within a particular farm district. In addition, there is a central bank in Washington. (Pet. App. C, pp. 9a–10a).

The Banks for Cooperatives were originally established by the Farm Credit Act of 1933, c. 785, 69 Stat. 655, to accomplish three congressional objectives: (1) to substitute borrower capital for the government's initial capitalization of the banks; (2) to establish a mechanism by which borrower cooperatives could

411-098—70

obtain increasing management, ownership and control of the banks; and (3) to pattern the banks' organization and operation after the "revolving fund" capitalization typical to cooperatives. See Farm Credit Act of 1953, c. 335, 67 Stat. 390, Section 2; S. Rep. No. 1201, 84th Cong., 1st Sess. pp. 1, 5–6.

The 1955 Act provides that the regional banks may issue three classes of stock. Class A stock represents the original capital contribution by the United States. It is non-voting, does not pay a dividend, and is to be retired at par according to a method which depends upon the amount of Class C stock purchased by cooperatives such as petitioners and upon the banks' net profits. Class B stock may be sold to any person, is nonvoting, and may pay a dividend not in excess of four percent. Class C stock is, in effect, the voting, common stock of the banks. The stock pays no dividends, and a shareholder of Class C stock is entitled to one vote, regardless of the number of shares of stock it owns. (Pet. App. C, pp. 10a–11a.)

The 1955 Farm Credit Act provides that cooperatives may acquire Class C stock in three ways. First, each cooperative is required to purchase one share of Class C stock at its $100 par value to be eligible to borrow. Second, each borrower is required to invest, quarterly, a specified amount in Class C stock. The amount to be invested is determined by each regional bank's board of directors, and is based on a percentage (not less than 10 percent nor more than 25 percent) of the interest payable by each borrower cooperative for that quarter. Third, Class C stock is

distributed to cooperatives as a distribution of the net profits of a regional bank, in which form they are referred to as "patronage dividends." The amount of the patronage dividend is that percentage of the bank's net profits which the interest earned on the borrower's individual loan bears to the total interest earned on the loans to all borrowers during that fiscal year. (Pet. App. C, pp. 10a–11a, 20a.).

Each of the petitioner cooperatives owned one eligibility share of Class C stock in the St. Louis Bank (Pet. 4, n. 2). Each also purchased additional shares of Class C stock in the Bank in connection with its loans from the Bank in the years in issue (Pet. App. C, p. 11a). And each received shares of Class C stock as patronage dividends in those years (Pet. App. C., pp. 19a–20a). Only the tax treatment of the additional Class C stock acquired in connection with loans is here in dispute.

The precise issue is whether petitioners' investments in such Class C stock were expenditures for capital assets within the meaning of Section 1221 of the Internal Revenue Code of 1954, or whether such expenditures were currently deductible business or interest expenses under Section 162 or 163 of the Code.

The district court held that petitioners' payments for Class C stock purchased in connection with the loans were not interest under Section 163, but were ordinary and necessary business expenses under Section 162 (Pet. App. C, pp. 13a–19a). On the government's appeal, the Eighth Circuit reversed, holding

that petitioners' payments for Class C stock were not deductible because the stock constituted a capital asset within the meaning of Section 1221.

In *Penn Yan Agway Cooperative, Inc.* v. *United States*, 417 F. 2d 1372 (Ct. Cl.), and *Mississippi Chemical Co.* v. *United States*, 1970–2 U.S.T.C., para. 9601 (C.A. 5), decided September 14, 1970, the Court of Claims and the Fifth Circuit considered the identical question with respect to purchases of the Class C stock of the Springfield, Massachusetts, and New Orleans Banks for Cooperatives. Those courts did not pass directly on the question whether the payments were deductible under Section 162, but held—directly contrary to the decision in the instant case—that the payments were deductible under Section 163.[1]

The question of statutory interpretation raised—whether Class C stock purchased in connection with Bank for Cooperatives loans is a capital asset within the meaning of Section 1221—involves a substantial amount of revenue and affects a large number of cooperative taxpayers. It also is important because uniform tax treatment of Class C stock is necessary for the proper administration of the congressionally established Banks for Cooperatives system.

[1] In *Penn Yan Agway*, the Court of Claims found that the stock, purchased at its par value of $100 per share, had a market value of $7 per share; it permitted an interest deduction for the remaining $93. In *Mississippi Chemical* the entire purchase price of the stock beyond a nominal value of $1 per share was held deductible. In the instant cases petitioners sought to deduct the entire purchase price.

In view of the conflict among the courts of appeals and the Court of Claims, a settled rule can be established only through review by this Court. Accordingly, we join in urging that the petition be granted.

Respectfully submitted.

ERWIN N. GRISWOLD,
Solicitor General.

DECEMBER 1970.

The government will shortly file a petition for a writ of certiorari in *Mississippi Chemical*, copies of which will be served on counsel for petitioners herein. That petition, however, might not be reached in the ordinary course in time for argument this Term. In view of the need for prompt resolution of the conflict that has developed, we respectfully suggest that the Court not suspend action on the petition in the instant case until filings in *Mississippi Chemical* have been completed.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1970

No. ~~824~~ 70-22

M.F.A. CENTRAL COOPERATIVE, ET AL., *Petitioners*

v.

EDWIN O. BOOKWALTER, District Director of Internal Revenue

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

REPLY BRIEF FOR PETITIONERS

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March, 1971

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IN THE

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OCTOBER TERM, 1970

No. 824

M.F.A. CENTRAL COOPERATIVE, ET AL., *Petitioners*

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REPLY BRIEF FOR PETITIONERS

On October 9, 1970, petitioners filed a petition for certiorari in this case, pointing out the square conflict between the decision of the Eighth Circuit herein and the decisions of the Fifth Circuit in *Mississippi Chemical Corporation* v. *United States*, 431 F. 2d 1320, 70-2 U.S.T.C. ¶ 9601 (Sept. 14, 1970), and of the Court of Claims in *Penn Yan Agway Cooperative, Inc.* v.

United States, 417 F.2d 1372 (1969). All of these cases involve the tax treatment of required purchases, by borrowers from a Bank for Cooperatives, of Class "C" stock of such Banks. In a Memorandum filed December 8, 1970, the Government acknowledged the conflict, and joined in urging that the petition be granted.

On December 10, 1970, the Government filed a protective petition for certiorari in *Mississippi Chemical* (No. 1082), suggesting that action thereon be deferred and that the case be disposed of on the basis of the decision in *M.F.A. Central*. On January 11, 1971, the taxpayer in *Mississippi Chemical* filed a response denying the existence of a conflict, but asserting its right to be heard if certiorari were granted, and stating that it would be unjust to have the issue decided on the basis of the *M.F.A. Central* case with no opportunity for Mississippi Chemical Corporation to be heard. The Government filed a reply brief on January 20, 1971, stating that the basic issue in all three cases is the same.

On February 22, 1971, this Court granted certiorari in *Mississippi Chemical* (No. 1082), but took no action in the present case, *M.F.A. Central* (No. 824), although the *M.F.A. Central* case was the earlier of the two cases. Apparently, the Court intends to dispose of the common issue on the basis of its decision in *Mississippi Chemical*.

Petitioners strongly urge the Court to grant certiorari in the present case and to set it for argument together with *Mississippi Chemical*, allowing M.F.A. Central Cooperative fifteen minutes for oral argument and increasing by fifteen minutes (to a total of 45)

the time allowed the Government in the two cases. Alternatively, petitioners move the Court to grant them the right to file a brief *amicus curiae* and to argue orally for fifteen minutes in that capacity, again increasing the total time granted the Government by the same amount.

The relief requested would not deprive petitioner in *Mississippi Chemical* of any of its allotted time for oral argument; and it would add no more than thirty minutes to the total time allocated for oral argument. Moreover, we respectfully submit, it would ensure that the basic legal issue common to the two cases would be argued pro and con without over-emphasis on factual distinctions, which, in our opinion, are not important to that basic issue.

The Solicitor General has authorized petitioners to state that the Government has no objection to the relief requested herein. The attorneys for Mississippi Chemical Corporation have authorized us to state that they have no objection to petitioners' participation in the *Mississippi Chemical* case as *amicus curiae*, including oral argument as requested above.

Respectfully submitted,

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March, 1971